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**Outlook for the Global Economy - 2001:
A Bumpy Odyssey**

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and
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Forecast Conference
March 13, 2001**

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Key Global Uncertainties in 2001

- ❑ Hard landing for the U.S.?
- ❑ Will Europe take over as the safe haven?
- ❑ Will Japan (ever) recover?
- ❑ Emerging Markets: More crises in the pipeline?
- ❑ The New Economy: Looking beyond the downturn.

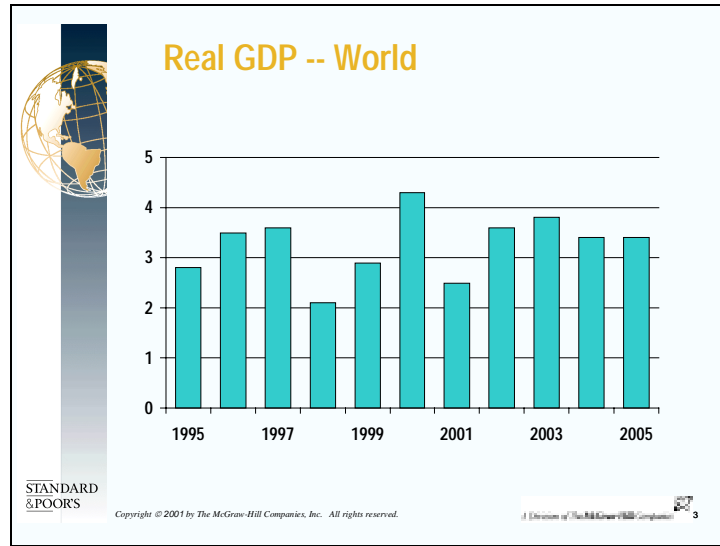
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Reasons for Pessimism

- ❑ Even a soft landing increases the vulnerability to a shock
- ❑ Global imbalances have not been (even partially) corrected by the recent spurt of growth
- ❑ Global deflation has reared its ugly head once again
- ❑ Europe is unlikely to become a growth locomotive
- ❑ Japanese growth is faltering -- again
- ❑ Turkey's troubles could be contagious

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Reasons for Optimism

- ❑ New Economy productivity surge will likely be sustained, albeit at a more moderate pace
- ❑ Banking systems are stronger now than in the early and mid-1990s
- ❑ Large currency swings are not inevitable
- ❑ Inflation is not a problem, even in the U.S. -- though energy prices will remain high
- ❑ In Europe and the U.S., there is scope for both fiscal and monetary stimulus


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Scope for Stimulus

	Fiscal Policy		Monetary Policy	
	Potential	Actual	Potential	Actual
U.S.	✓	✓	✓	✓
EU	✓	✓	✓	?
Japan	x	?	x	x

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1991-2000: It Was a Great Party for the U.S.


- Unemployment rate fell from 7.8% to 4.0%
- Core inflation fell from 5.5% to 2.5%
- Total return on S&P 500 averaged 17.5% per year
- Federal surplus rose from -\$270 billion to \$240 billion (from -4.5% of GDP to 2.4%)
- Real wages per workers rose 1.6% per year, compared with 0.5% in 1980s

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**But Now It's the Morning After
and We Wake Up to Discover...**

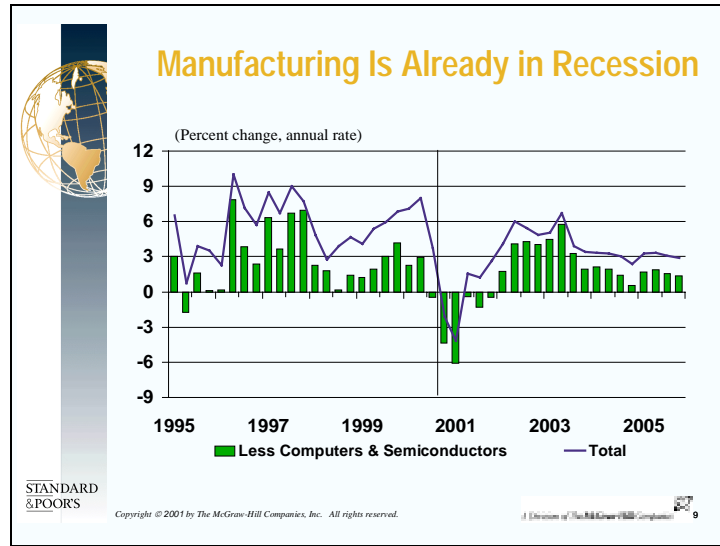
- ❑ The saving rate has fallen from 8% to -1%
- ❑ Debt (mortgage + non-mortgage) has risen from 76% to 94% of disposable income
- ❑ The internet is not the best thing since sliced bread
- ❑ 25 companies cannot each have 5% of the market
- ❑ There's an energy crisis

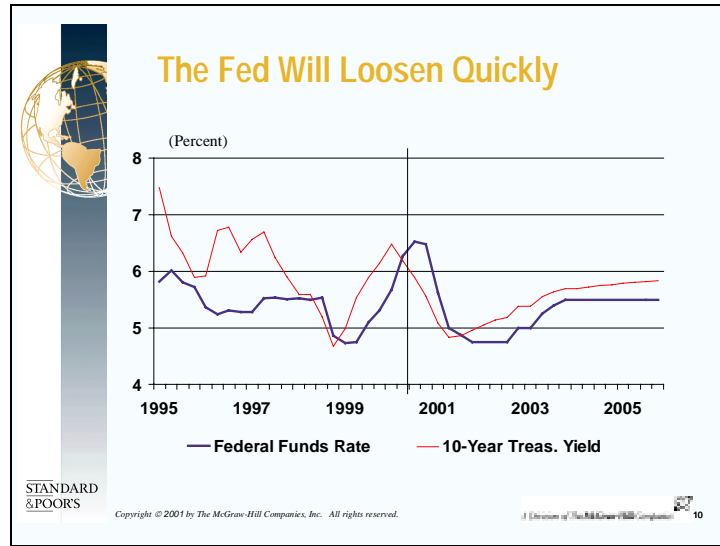
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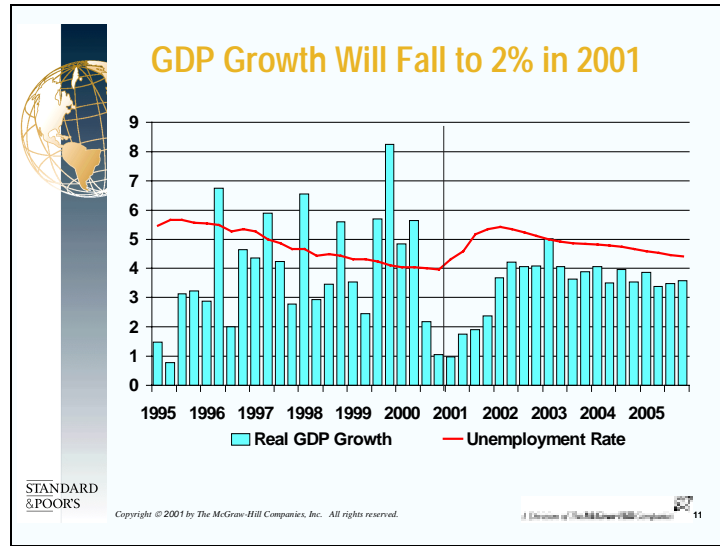
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Risks to Watch (and Be Prepared) For


- ❑ The energy shortage worsens and forces large-scale layoffs
- ❑ Consumers have difficulty paying for past extravagance
- ❑ The dollar falls sharply as capital inflows shrink
- ❑ Long-term interest rates rise with passage of large tax cuts

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The New Economy: Looking Beyond the Downturn


- ❑ The New Economy was always about the medium- to long-run
- ❑ Total factor productivity (TFP) growth is more important than capital accumulation
- ❑ The collapse in high-tech stock values says nothing about TFP growth
- ❑ A cyclical downturn in labor productivity also says nothing about TFP growth

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The New Economy: Looking Beyond the Downturn (Continued)

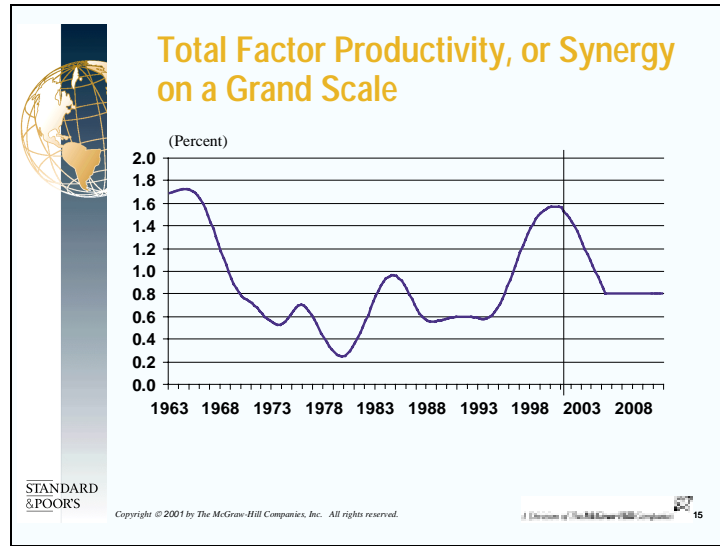
- “Over-investment” in equity-financed, high-tech investments (with high depreciation rates) are easier to work off than bank-financed investments in real estate or industrial capacity
- The optimistic view: This technological “revolution” has just begun

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Europe: The New Safe Haven?

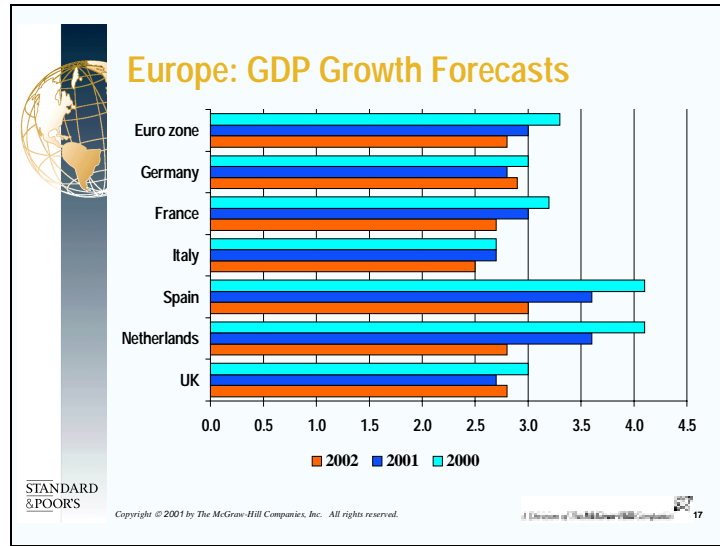
- Positive trends
 - ◆ Confidence is high
 - ◆ Major tax cuts in pipeline
 - ◆ Growth is more balanced
- Risks
 - ◆ Euro becomes too strong
 - ◆ ECB too stingy
 - ◆ U.S. hard landing

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Will Japan (ever) Recover?

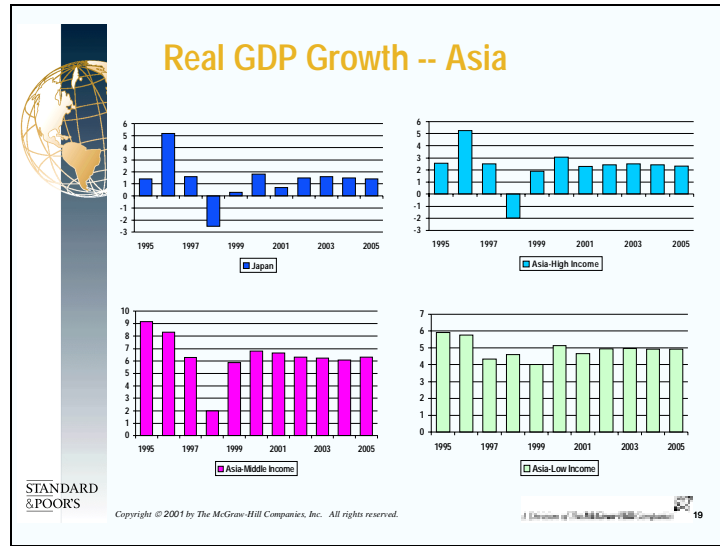
- Recovery
 - ◆ Corporate and financial restructuring is underway
 - ◆ High-tech sectors (esp. wireless) have done well
 - ◆ Need a fire-sale of nonperforming bank assets
- Relapse
 - ◆ Fragile financial and corporate sectors
 - ◆ Consumers are worried
 - ◆ Only real policy option is regulatory - and its use is resisted

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Asia: End of a "False" Recovery?

- Real recovery
 - ◆ Fastest growing region of the world
 - ◆ Growth fundamentals remain strong (e.g., rising educational attainment, high saving rates, etc.)
- False recovery
 - ◆ Excess capacity, high debt levels and deflation persist
 - ◆ The reform process has moved too slowly
 - ◆ Vulnerability to a U.S. recession and/or a weak yen

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Latin America: Another Close Call

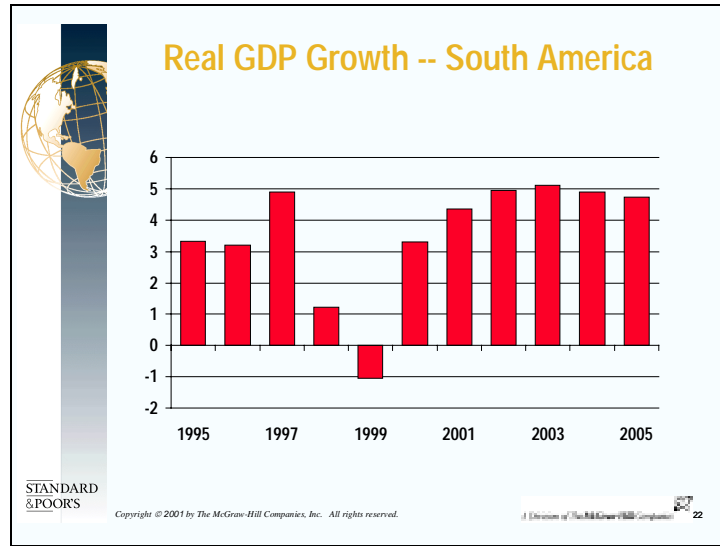
- Sustained rebound ...
 - ◆ The recent recovery has been strong, with a few exceptions
 - ◆ The region is not burdened by the same problems as Asia
 - ◆ Lower interest rates in the U.S. will help
- ... or renewed crises?
 - ◆ Financial fragility is still a problem
 - ◆ More structural reforms needed (pensions, infrastructure, etc.)


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Other Emerging Markets -- More Crises in the Pipeline?

- Vulnerabilities
 - ◆ Even weaker growth in the G7
 - ◆ High oil prices
 - ◆ Weaker commodity prices
 - ◆ Greater risk aversion among investors
- Favorable trends
 - ◆ Exchange rates are more flexible
 - ◆ Debt levels are mostly lower
 - ◆ The IMF is coming to the rescue more quickly

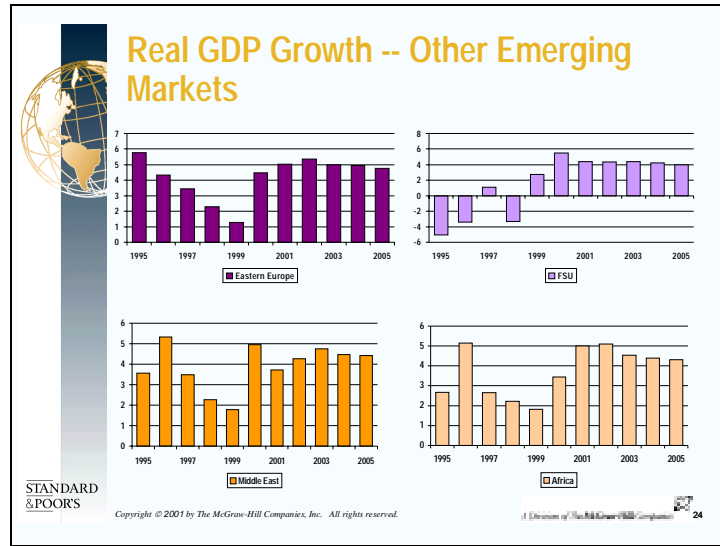
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Global Impact of a U.S. Hard Landing

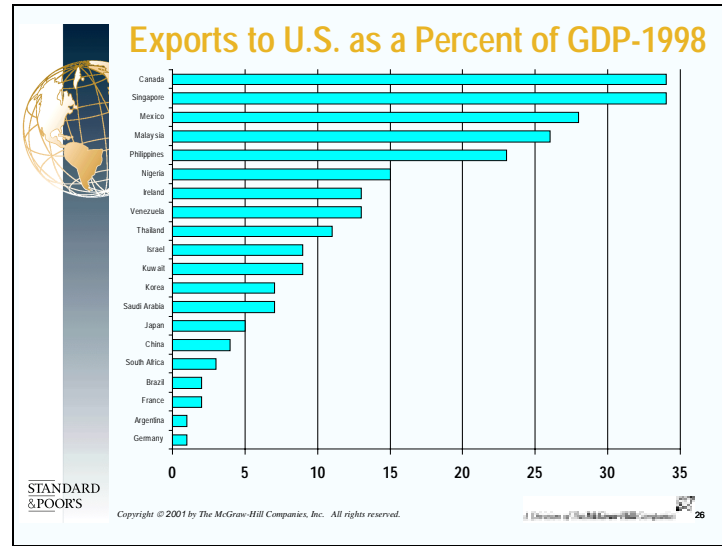
(Impact on Real GDP Growth)						
	U.S. Recession	Higher Interest Rates	Dollar Crash	Stock Market Crash	Collapse in Commodity Prices	
N. America	↓ ↓	↓ ↓ ↓	↑ ↓ ↓	↓ ↓ ↓	↓ ↓	↑ ↓
S. America	↓ ↓	↓ ↓ ↓	↑ ↓ ↓	↓ ↓ ↓	↓ ↓	↓ ↓
Asia	↓ ↓	↓ ↓	↓ ↓	↓ ↓ ↓	↓ ↓	↓ ↓
W. Europe	↓ ↓	↓ ↓ ↓	↓ ↓ ↓	↓ ↓ ↓	↓ ↓	↑ ↓
E. Europe	↓ ↓	↓ ↓	↓ ↓	↓ ↓ ↓	↓ ↓	↑ ↓
FSU	↓ ↓	↓ ↓	↓ ↓	↓ ↓ ↓	↓ ↓	↓ ↓
Mid-East	↓ ↓	↓ ↓	↓ ↓	↓ ↓ ↓	↓ ↓	↓ ↓
Africa	↓ ↓	↓ ↓	↓ ↓	↓ ↓ ↓	↓ ↓	↓ ↓

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Bottom Line

- ❑ A soft landing is still the most likely scenario ...
- ❑ ... but the risk of a hard landing has risen in recent weeks
- ❑ A lot will depend on how aggressively the Fed and the ECB cut interest rates
- ❑ New Economy productivity gains are likely to persist beyond the current cycle

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